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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1942

No. [redacted] 93

CHARLES J. McCOLGAN, Franchise Tax Commissioner of the State of California,
Petitioner,

vs.

MAIER BREWING COMPANY, a corporation, and H. F. METCALF, Trustee of the Estate of Maier Brewing Company, Debtor,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

Petitioner, Charles J. McColgan, Franchise Tax Commissioner of the State of California, respectfully prays that a writ of certiorari issue to review

the judgment of the United States Circuit Court of Appeals for the Ninth Circuit, entered in the above entitled cause on March 10, 1943, affirming the judgment of the United States District Court for the Southern District of California, Central Division.

OPINION BELOW

The opinion of the Circuit Court of Appeals is reported in 134 Fed. (2d) 385, and will be found in the Record herein at page 182.

JURISDICTION

The judgment sought to be reviewed was entered on March 10, 1943. The jurisdiction of this court is invoked under section 240(a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether, under section 124(a), 28 U.S.C.A., a state may acquire, pursuant to its own statutes, a lien for state taxes on property in the hands of a Receiver appointed by a District Court of the United States following the filing of an involuntary petition in bankruptcy, said Receiver being authorized by the court to carry on the business of the alleged bankrupt and actually operating said business.

2. Whether, under the facts shown by the record herein the court below was justified in its conclusion that the State Franchise Tax Commissioner

knew or should have known that the Receiver was operating the business, notwithstanding the Receiver's neglect to file returns and his statements that "In Bankruptcy Receivership—no business transacted."

3. Whether, under the facts shown by the record herein the court below was justified in holding the Commissioner's tax claim was "stale."

4. Whether the court below, under the facts shown by the record herein, was justified in denying petitioner's claim for taxes for the years 1934, 1935, 1937 and 1938, amounting with interest and penalties to $8,858.19, assessed against respondent corporation by reason of the net income from operations by the Receivers in those years.

5. Whether the court below erred in holding that section 124(a), 28 U.S.C.A., does not in terms or by implication impair the principle that property in the custody of the bankruptcy court may not be subjected to liens while so held.

(Note: After termination of the receiverships, the properties were returned to respondent corporation in 1939 and thereafter were operated by the corporation until the appointment in December, 1940, of a trustee in the present Chapter X proceeding.)

STATUTES INVOLVED

The statutes involved will be found in the Appendix hereto.

STATEMENT

(a) Facts in Bankruptcy Petition No. 18884-H

In June, 1932, an involuntary Petition in Bankruptcy was filed against Maier Brewing Company, No. 18884-H.

Myron H. Wells was appointed Receiver with authority to manage, control and operate the business and property of the alleged bankrupt (Tr. 88), and did so operate the business until July 10, 1935, at which time his resignation was accepted and Philip L. Wilson was appointed Receiver in his place with the same powers. Wilson operated the business until September 10, 1938 (Tr. 90).

During Wells' operation of the business franchise taxes were assessable under the Bank and Corporation Franchise Tax Act (Stats. 1929, page 19, as amended) for the years 1934 and 1935, based on net income for the preceding years.

It was stipulated by counsel in the proceedings before the special master that the amount of taxable income as the basis for the tax in 1934 was $75,018.32, and for the tax in 1935 was $34,157.49. (Tr. 100.) Federal taxes were paid by Wells on the above bases.

While filing federal returns and paying large sums as taxes Wells for some reason not clearly disclosed but presumably on the advice of counsel apparently considered that no taxes were payable to the State on the net income of his operations. He did pay the minimum tax of $25.00. On February

23, 1933, Wells wrote the Franchise Tax Commissioner a letter which is set forth in full at page 93 of the Transcript.

On March 12, 1934, Wells sent the Commissioner a check for $25 accompanied by a verified return in blank, across the face of which was written:

> "Corporate powers suspended by the United States District Court, Southern District of California, Central Division, in Re Maier Brewing Company, No. 18884-H, Myron H. Wells, Receiver in Bankruptcy." (Tr. 94.)

Under section 124, U.S.C.A. he should have made a return reporting net income as was done with the federal government.

On September 5, 1934, Wells wrote the Commissioner as follows:

> "Please advise me the amount of franchise tax owing by the Maier Brewing Company. This company has been in receivership since June, 1932, *and no operations have been carried on by the corporation.*" (Emphasis supplied). (Tr. 94.)

To this letter the Commissioner replied:

> "Tax liability *of record of the subject corporation* for the taxable year ending December 31, 1934, *as disclosed by return of operations filed for the taxable year ended December 31st, 1933,* has been entirely satisfied." (Emphasis supplied.) (Tr. 95.)

This letter was, of course, based on Wells' return of March 12, 1934, above referred to, and had no

connection with any possible liability of Wells for his operations as receiver.

On January 10, 1935, Wells filed a verified return in blank except for the notation "In Bankruptcy Receivership No Business Transacted (Tr. 95).

On February 12, 1935, Wells wrote the Commissioner as follows (Tr. 95):

> "In answer to your demand for supplemental data, dated February 11, I am the Federal Receiver in Bankruptcy of the Maier Brewing Company and was, during all of the calendar year 1933.
>
> *I am not operating the corporation* and the Maier Brewing Company's corporate powers were suspended at the date of my appointment." (Emphasis supplied.) (Tr. 95.)

It is thus clear that the Receiver made no disclosure at any time to the Commissioner covering his activities in operating the business and completely failed to report the income therefrom or to pay any taxes in connection therewith to the State although in 1934 and 1935 he paid large sums as taxes to the federal government. The returns, such as they were, were corporate returns and not returns of his own activities as Receiver.

Receiver Philip L. Wilson, appointed on July 10, 1935, continued to operate the business down to September 10, 1938, a period of more than three years, apparently without making any State returns

whatever although federal returns were made and taxes paid on net income in the following amounts:

Tax year	*Amount of Taxable Income*
1937	$41,859.98
1938	58,231.43 (Tr. 100)

All of Receiver Wilson's operations were carried on while section 124a, 28 U.S.C.A. was in force. He filed the Eighteenth and Final Report which was approved by the court on October 4, 1938 (Tr. 90).

The special master stated in his report (Tr. 91) that in Wilson's final report there was no mention of any obligation for franchise taxes to the State.

In March of 1939 the petition in bankruptcy was dismissed, the proceedings terminated and the property restored to the company (Tr. 91) which operated it until December 4, 1940, when the present proceedings commenced (Tr. 99).

The special master calls attention to the fact that in proceeding No. 18884 various notices to creditors were published in Los Angeles papers (Tr. 91) and to the testimony given at the hearing before him by Mr. Bondeson (Tr. 98) and concluded that the Commissioner had notice of the receivership proceedings in case No. 18884 and of the fact that the respective receivers were operating the business and property of the Maier Brewing Company.

His conclusion was based upon "the foregoing oral and documentary evidence." (Tr. 98-99.)

The oral evidence was the testimony given by Mr. Bondeson, Deputy Commissioner, and the docu-

mentary evidence presumably included the Receiver's letters and returns and the published notices to creditors. The trial court approved the findings of the special master except that the court stated:

> "Accordingly, I have concluded that Mr. Bondeson did not have personal notice that the receiver of the debtor was operating its business during any portion of the period that the receivership was in effect." (Tr. 132.)

The only basis for the court's conclusion, that the Commissioner had notice, therefore, was the documentary evidence consisting of letters, the so-called returns and the published notices.

No obligations for the payment of franchise taxes to the State of California were listed by receiver Wilson in his final report in No. 18884 (Tr. 91).

(b) Facts in Bankruptcy Petition No. 37544-H, Now Pending in the United States District Court

Pursuant to a Petition by creditors of Maier Brewing Company, a corporation, for approval of a plan of reorganization (Tr. 2) the District Court, on December 19, 1940, made an order approving the petition and appointing Frank C. Mortimer as Trustee of the Estate of Maier Brewing Company and Ed R. Maier as Additional Trustee, said appointments not to be effective until December 28, 1940. This proceeding is numbered 37544-H.

On February 7, 1941, appellant filed a claim for taxes against said debtor corporation pursuant to

the Bank and Corporation Franchise Tax Act, in the aggregate amount of $10,182.54 (Tr. 36), the items comprising said amount being set forth in the transcript at pages 38-40.

Thereafter the Commissioner filed an amendment to his claim in which he set forth that the taxes for the years 1934 and 1935 were a lien on *all* property of the debtor and the taxes for the years 1937, 1938, 1939 and 1940 were a lien on the *real* property of the debtor (Tr. 115).

Thereafter Trustee Mortimer filed his objections to appellant's claim (Tr. 40), and the debtor corporation also filed its objections to said claim (Tr. 45-80).

On May 16, 1941, the court made an order of reference to a special master (Herman A. Backrack) to hear the objections (Tr. 81) and on October 6, 1941, the special master made his report (Tr. 85-126).

The special master's report recommended the allowance of appellant's claim in the sum of $1,324.35, and recommended disallowance of all of appellant's claim over and above that amount (Tr. 113).

Appellant duly filed his objections to the special master's report (Tr. 127) and on March 3, 1942, the court re-opened the proceedings and permitted further testimony to be taken with a view to explaining certain testimony given at the hearing before the special master (Tr. 155).

Thereafter, on May 21, 1942, the court filed a memorandum of its conclusions in respect to the objections to the special master's report and therein referred to the additional evidence presented in open court on March 3, 1942 (Tr. 155) and in that memorandum the court said:

> "During the taking of this additional evidence, the witness was subjected to a searching cross-examination. I am now satisfied that he did not intend to answer the aforementioned questions in the manner in which he did before the Special Master. Accordingly, I have concluded that Mr. Bondeson did not have personal notice that the receiver of the debtor was operating its business during any portion of the period that the receivership was in effect.
>
> In all other respects, however, I am satisfied that the record supports the findings of fact as reported by the Special Master." (Tr. 132.)

The District Court then made an order reading as follows:

> "For the reasons set forth in the Memorandum of Conclusions this day filed, it is ordered that the claim of the Franchise Tax Commissioner of the State of California be allowed as a preferred claim only in the sum of $1,324.35, plus interest as prayed for, and that all of the remainder of said claim be disallowed."

From this order an appeal was taken to the Circuit Court of Appeals for the Ninth Circuit, and that court on March 10, 1943, affirmed the District

Court. This petition for writ of certiorari is to secure a review of the last-mentioned judgment.

GROUNDS ON WHICH THE DECISION OF THE COURT BELOW RESTS

The Circuit Court of Appeals for the Ninth Circuit apparently based its decision upon the following grounds:

1. That the claim of the Franchise Tax Commissioner was barred by failure seasonably to present it. (The court did not say in so many words that the claim was barred by the statute of limitations contained in the Bank and Corporation Franchise Tax Act, but such may be inferred from the court's opinion (R., p. 182, at p. 186).)

2. That state statutes imposing liens for taxes on property of the taxpayer are set aside and rendered inapplicable where the property is in the hands of a Receiver, appointed by a United States District Court, who is operating the taxpayer's business and who is, therefore, governed by the provisions of section 124(a), 28 U.S.C.A. In other words, that a lien for state taxes may not attach to a taxpayer's property while the Receiver is in charge and operating the property for the benefit of the taxpayer and its creditors.

3. That the so-called "returns" filed by the Receiver were sufficient to put the Franchise Tax Commissioner on notice that the Receiver was operating the business and therefore were sufficient to start the running of the statute of limitations.

4. Assuming, as the court did, that the Commissioner was guilty of laches, that such laches was imputable to the State in its sovereign capacity and rendered the State's claim for taxes "stale."

5. That the equities of the State's situation were less than those of creditors in the plan of composition effected in 1938, and less than those of creditors in the pending proceeding, which creditors the court said "can hardly escape prejudice if this stale claim were now to be allowed." (R., p. 182, at p. 189.)

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals for the Ninth Circuit erred:

1. In holding that a state statute imposing liens for taxes on property of a corporate taxpayer is set aside and made inapplicable where the property is in the hands of a Receiver who is operating the taxpayer's business, notwithstanding the provisions of section 124(a), 28 U.S.C.A.

2. In holding that the claim of the State of California was barred by failure seasonably to present it.

3. In holding that the so-called "returns" filed by the Receiver (containing no information respecting his operation of the business and no information respecting the net income therefrom, but indicating that he was not operating the business) were sufficient to start the running of the statute of limitations, contrary to the provisions of the taxing act.

4. In holding that the alleged laches of the Franchise Tax Commissioner was imputable to the State

in its sovereign capacity and rendered the State's claim "stale."

5. In holding that the equities of the State's situation were less than and subordinate to the assumed equities of creditors in the plan of composition effected in 1938 (in no way involved herein), and less than and subordinate to the assumed equities of creditors in the pending proceeding (there being no evidence or finding that the respondent corporation is insolvent or unable to pay the State's claim as well as the claims of all other creditors in the pending proceeding).

6. In holding that the State was not entitled to recover, or to have allowed as a claim in the pending proceeding, the sum of $8,858.10, representing taxes, penalties and interest assessed under authority of the Bank and Corporation Franchise Tax Act and section 124 (a), 28 U.S.C.A., measured by the net income of the Receivers from operation of the taxpayer's business.

REASONS FOR GRANTING THE WRIT

We respectfully represent the writ should be granted because:

1. The decision herein conflicts with the decision of this court in *Boteler* v. *Ingels,* 308 U. S. 57, and with the lower court's own decision in that case, reported at 100 Fed. 2d 915, and with the same court's decision in *State* v. *Hisey,* 84 Fed. 2d 802.

The Ninth Circuit Court in the instant case said, referring to section 124 (a), 28 U.S.C.A., that:

> "The statute does not in terms or by implication impair the principle that property in the custody of the bankruptcy court may not be subjected to liens while so held."

The only case cited was *Straton* v. *New,* 283 U. S. 318, 321.

While it is true that in *Straton* v. *New* this court said that from the filing of the petition in bankruptcy the estate is regarded as *in custodia legis* and thereafter liens cannot be obtained nor proceedings had *in other courts* to reach the property, we respectfully submit that this was *dicta* because the liens there involved had accrued sixteen months prior to the filing of the petition in bankruptcy.

It was held that the bankruptcy court had no power to enjoin proceedings in a state court to enforce the liens. There was no mention of section 124 or 124(a). In fact, the latter section was not then in existence.

It seems clear, therefore, that *Straton* v. *New* does not support the lower court's conclusion. In any event, it appears from the cases cited by the court at page 321 that the extent of the holding was that while the property of the estate was *in custodia legis* in a certain court sitting in bankruptcy, liens could not be obtained nor proceedings had *in other courts* to reach the property. In each of the following cases cited by this court at page 321, the hold-

ing was that the court of original jurisdiction had exclusive control of the estate and that *other courts* would not interfere.

Murphy v. *John Hoffman Co.,* 211 U. S. 562;
U. S. Fidelity Co. v. *Bray,* 225 U. S. 205;
Hebert v. *Crawford,* 228 U. S. 204;
Lazarus v. *Prentice,* 234 U. S. 263.

Here, of course, no court except the court of original jurisdiction is involved, and in that court Petitioner is seeking the relief by way of lien which is accorded it by the State statute.

Section 124(a), 28 U. S. C. A., provides in part:

> "Any receiver, liquidator, referee, trustee, or other officers or agents appointed by any United States court who is authorized by said court to conduct any business, or who does conduct any business, shall, from and after June 18, 1934, be subject to all State and local taxes applicable to such business *the same as if such business were conducted by an individual or corporation.*" (Emphasis added.)

This section has been construed in at least two cases by this court. The first case was *Boteler* v. *Ingels,* 308 U. S. 57, on certiorari to the Ninth Circuit Court of Appeals.

In that case penalties were involved incurred by a Receiver operating under section 124(a). The penalties were imposed under the state statute, but it was contended by the respondent that the allowance of such penalties was prohibited by section 57(j) of the Bankruptcy Act. In disposing of this

contention this court, at page 60, referred to the legislative history of section 124(a) and remarked that it indicated "a congressional purpose to facilitate—not to obstruct—enforcement of state laws, the court below correctly recognized and applied this congressional purpose and its judgment is affirmed."

In the instant case the court below failed to recognize or apply the congressional purpose and consequently rendered an erroneous decision which can be reversed only through the granting of certiorari herein.

The imposition of penalties is one "traditional and almost universal method of enforcing prompt payment" of taxes. Another method of enforcing payment of taxes, also traditional and almost universal, is to support the same by statutory liens. Here the State statute provides for a lien, but the court below held that it does not attach because the property was *in custodia legis.*

The second case decided by this court which construed section 124 (a) was *Palmer* v. *Webster & Atlas Bank,* 312 U. S. 156. In that case this court, referring to the act adopting section 124 (a), said at page 163:

> "The legislative history of the Act discloses its purpose. The committee reports accompanying the bill which became the Act of 1934 state: 'The purpose of this bill is to subject businesses conducted under receivership in Federal courts to State and local taxation the same as if such

businesses were being conducted by private individuals or corporations.' The reports advert to the fact that federal courts had held a federal receiver operating a business exempt from state sales taxes. They conclude: 'No good reason is perceived why a receiver should be permitted to operate under such an advantage as against his competitors not in receivership, and the States and local governments be deprived of this revenue.'

What Congress intended was that a business in receivership, or conducted under court order, should be subject to the same tax liability as the owner would have been if in possession and operating the enterprise.''

Neither in the *Boteler* case nor in the *Palmer* case did this court even suggest any qualification or interpretation of section 124 (a) such as the lower court here introduced. The section, as we interpret it, and as this court apparently has interpreted it in the two cases above referred to, permits State law the *same operation and effect* as applied to an operating receiver as to an operating corporation. But the court below makes an important distinction. That court holds that the law which gives the state a lien for taxes against the property of an operating corporation *does not* give the state a lien against the property in the custody of an operating receiver.

This distinction, we submit, is not founded on anything in the section itself or in any case construing it, but merely rests upon some idea now entertained by the court that property in the cus-

tody of a bankruptcy court is somehow sacred and inviolable, notwithstanding the fact that the property is being actively employed and used by the court-appointed receiver in the same manner that it was formerly employed and used by its corporate owner.

The court's decision construed section 124 (a) in a way which obstructed the purpose of Congress instead of facilitating that purpose. This court, in the *Boteler* case, said that the purpose of Congress in enacting section 124 (a) was "to facilitate—not to obstruct—enforcement of State laws."

State law is not enforced when the court refuses to apply the law and says there is no lien when the statute positively and expressly provides a lien. Section 29 of the Bank and Corporation Franchise Tax Act as it read in 1934, when the first tax lien accrued, read:

> "The taxes levied under this act shall constitute a lien upon all property of the taxpayer, which lien shall attach on the first Monday in March of the year in which the taxes accrue . . . Every tax herein provided for has the effect of a judgment against the taxpayer, and every lien has the effect of an execution duly levied against all property of the delinquent, and the judgment is not satisfied nor the lien removed until the tax and the penalty are paid, or the property sold for the payment thereof . . ." (Stats. 1933, p. 692, at 703.)

Section 29 was amended in 1935 (Stats. 1935, p. 959, at 979) and the lien provision remained substantially as before except that it was provided that the lien should attach "on the first day of the 'taxable year'."

Section 29 was again amended in 1937 (Stats. 1937, p. 2324, at 2344). The only material change so far as we are here concerned was that the tax was made a lien upon real property only, instead of upon all property of the taxpayer.

It will thus be seen that the taxes for the 1934 and 1935 taxable years were a lien upon *all* the property of the corporation, while the taxes for 1937 and 1938 were a lien only on the corporation's real property.

Under the decisions of this court in the *Boteler* and *Palmer* cases, *supra,* it was the duty of the court below to apply the State statutes above referred to and to hold that liens for the taxes attached to respondent corporation's property as follows:

1934-1935 taxes on all such property;
1937-1938 taxes on all the real property.

Since returns were not filed by the two Receivers as required by the act, it was the further duty of the court below to apply the provisions of the act and to hold that the assessments later made by the Commissioner were not barred (section 16), and that the statutory liens were not discharged (section 29).

Receiver Wilson made no attempt at all to file returns for the years 1937 and 1938 and did not mention State taxes in his final report. Nevertheless the courts below held, contrary to the plain provisions of the act, that taxes for these years also were barred.

The mandate of section 124(a) that the Receiver shall be subject to taxation "the same as if such business were conducted by an individual or corporation" was ignored by the court below on the sole authority of *Straton* v. *New, supra,* which was decided prior to the enactment of section 124(a).

This error can not be corrected unless this court grants the petition herein.

The interpretation given by us to section 124(a) is, we believe, fully approved and adopted by the Supreme Court of California in *Fifth Street Building* v. *McColgan,* 19 Cal. (2d) 143, at 145, and by the respective courts, including this court, which decided the cases cited in the quotation below.

At page 145 of the case above mentioned the court said, referring to section 124(a):

> "This language envisages precisely such situations as the present one. The trustee, appointed after June 18, 1934, by a United States court, conducted the business theretofore carried on by Walkers Inc., then subject to the franchise tax as it would have continued to be had it not gone into bankruptcy. The Act of Congress makes it clear that the appointment of a trustee in bankruptcy by a federal court does not relieve a business of the state and local taxes to which it

is normally subject. 'What Congress intended was that a business in receivership or conducted under court order, should be subject to the same tax liability as the owner would have been if in possession and operating the enterprise.' (*Palmer* v. *Webster & Atlas Nat. Bank* v. *Boston,* 312 U. S. 156 (61 Sup. Ct. 542, 545, 85 L. Ed. 642); see also, *Philadelphia Co. et al.* v. *Dipple,* 312 U. S. 168 (61 Sup. Ct. 538, 85 L. Ed. 651); *Boteler* v. *Ingels,* 308 U. S. 57 (60 Sup. Ct. 29, 84 L. Ed. 78); *Thompson* v. *Louisiana,* 98 Fed. (2d) 108; *In re Vicksburg Bridge & Terminal Co.,* 24 Fed. Supp. 123; *International Shoe Co.* v. *Pickard & Geismar,* 30 Fed. Supp. 570; *In re Kentucky Fuel Gas Corp.,* 37 Fed. Supp. 625; *The Southern Cross,* 120 Fed. (2d) 466.)"

This court denied certiorari (316 U. S. 648).

It was settled in *Boteler* v. *Ingels, supra,* not only that a trustee in bankruptcy comes within the meaning of the Act of Congress and can not therefore escape the applicability of a state tax, but that the trusteeship can in no way militate against *the effective enforcement of the tax.* (Italics supplied.)

This petition and supporting brief is already longer than we intended, for which we offer our apologies to the court, and therefore we will not discuss in detail the further errors of the lower court which have been referred to herein. These errors were cumulative in effect and were the outgrowth of the court's primary error respecting the construction of section 124(a) in regard to the State's lien for the taxes.

We respectfully pray that the Writ of Certiorari be granted.

Dated: May 24, 1943.

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HARTWELL H. LINNEY,
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APPENDIX

Bank and Corporation Franchise Tax Act

SEC. 16:

"If any return required by this act is not made, it shall be the duty of the commissioner to make an estimate of the net income, from any available information, and to compute and levy the amount of tax due under this act. All the provisions of this act relative to delinquent taxes shall be applicable to the tax computed and levied hereunder." (Stats. 1929, p. 27, as amended by Stats. 1935, p. 972.)

SEC. 29:

"The taxes levied under this act shall constitute a lien upon all property of the taxpayer, which lien shall attach on the first Monday in March of the year in which the taxes accrue * * *. Every tax herein provided for has the effect of a judgment against the taxpayer, and every lien has the effect of an execution duly levied against all property of the delinquent, and the judgment is not satisfied nor the lien removed until the tax and the penalty are paid, or the property sold for the payment thereof * * * ." (Stats. 1933, p. 692, at 703).

SEC. 29 (as amended by Stats. 1935, p. 959, at p. 979):

"The taxes levied under this act shall constitute a lien upon all property of the taxpayer, which lien shall attach on the first day of the 'taxable year' * * *. Every tax herein provided for has the effect of a judgment against the taxpayer, and every lien has the effect of an execution duly levied against all property of the delinquent, and the judgment is not satisfied nor the lien removed until the tax, and

the penalties, and interest are paid, or the property sold, for the payment thereof * * *."

SEC. 29 (as amended by Stats. 1937, p. 2324, at page 2344):

"The taxes imposed by this act shall constitute a lien upon the real property of the taxpayer, which lien shall have the same force, effect and priority as a judgment lien and shall attach on the first day of the 'taxable year' * * *. The lien provided for in this section shall remain until the taxes are paid or the property subject to the lien is sold for the payment thereof, or until the lien is released or otherwise extinguished * * *."

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IN THE

Supreme Court of the United States

October Term, 1942.

No. 1083. 93

CHARLES J. McCOLGAN, Franchise Tax Commissioner of the State of California,

Petitioner,

vs.

MAIER BREWING COMPANY, a corporation, and H. F. METCALF, Trustee of the Estate of Maier Brewing Company, Debtor,

Respondents.

ANSWER TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

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IN THE

Supreme Court of the United States

October Term, 1942.

No. 1083.

CHARLES J. McCOLGAN, Franchise Tax Commissioner of the State of California,

Petitioner,

vs.

MAIER BREWING COMPANY, a corporation, and H. F. METCALF, Trustee of the Estate of Maier Brewing Company, Debtor,

Respondents.

ANSWER TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

To the Honorable Chief Justice and to the Honorable Associate Justices of the Supreme Court of the United States:

Respondents respectfully urge that the decision of the Circuit Court of Appeals for the Ninth Circuit in this cause is eminently correct, does not conflict with the decision of this court in any particular, and that petitioner is not entitled to recover the tax demanded.

The Decision in the Case at Bar Does Not Conflict With the Decision of This Court in the Boteler Case or With the Decision of the Circuit Court of Appeals in the Hisey Case.

In both the *Boteler case* (*Boteler v. Ingels, Director of Motor Vehicles of the State of California, et al,* 308 U. S. 57) and in the *Hisey* case (*State of California v. Hisey,* Circuit Court of Appeals for the Ninth Circuit, 84 Fed. Rep. (2d) 802) the court was dealing with a situation where the taxing authority sought to collect taxes and penalties during the pendency of the respective proceedings and as an expense of administration. In the case at bar, petitioner accepted from year to year the franchise tax paid by the respective receivers in bankruptcy of debtor corporation for the right "to be" and never at any time demanded or sought to collect any additional tax upon the right "to do." On the contrary, petitioner, after having written the respective receivers that the franchise tax liability had been discharged in full, sat idly by, notwithstanding full knowledge during the years that the receivers were operating debtor's business and with constructive knowledge, at least, that the receivers were enjoying a taxable profit in such operations, and permitted the approval of a plan of composition and the return of the assets to the corporation free of liens. The order approving the composition entered in the former *involuntary* bankruptcy proceedings in September 1938, specified the obligations of Maier Brewing Company which might thereafter be enforced against the corporation and such detail of obligations did not include any debt owing to petitioner.

Thereafter petitioner, without attempting to assess the additional tax liability herein claimed, made no demand

upon the corporation, and in January, 1941, after the commencement of the present Chapter X proceedings against debtor for the first time assessed or attempted to assess this additional tax claim. Thus the statement of petitioner on page 4 of his petition filed herein that "franchise taxes were *assessable*" for the years 1934 and 1935 should not be understood as an assertion that during that period or any period prior to January, 1942, any such additional taxes were *assessed.*

In the *Botcler* case no complaint was made of the order against the taxing authority permitting the filing of claims for taxes which the District Court considered proper "within thirty days or be forever barred" (308 U. S. at p. 58), but on the contrary the complaint there made by the taxing authority was that he had been denied his claim for penalties.

A debt or an obligation is the *sine qua non* of the existence of a lien.

The Circuit Court of Appeals in the case at bar has properly held that under the findings and decision of the District Court and the meager record as presented to the Circuit Court of Appeals, no debt or obligation of debtor to petitioner now exists.

That court in the decision now under attack properly held that 28 U. S. C. A., Section 124(a) imposed the obligation upon the bankruptcy receiver to pay the California franchise tax for the right to do as well as for the right to be. This tax, so the Circuit Court said, was an expense of administration citing in support thereof *Gillis v. California*, 293 U. S. 62, and *Botcler v. Ingels*, 308 U. S. 57, which latter case petitioner now contends was not followed. These taxes being an expense of ad-

ministration must be "settled while the property yet remains in the custody of the court." If not so settled, the taxing authority is and should be denied a lien. The lien only arises when a debt exists.

Moreover, the record discloses that in September, 1938, a composition was effected by the aid of new money, and certainly that lender as well as all those who remained creditors of the alleged bankrupt, were entitled to know at the time of supplying the new cash and consenting to the composition, the full amount of the alleged bankrupt's obligations.

Petitioner, while recognizing that it was the duty of the respective receivers to pay all properly assessed franchise taxes arising during the course of their receivership, now takes the position that notwithstanding the neglect of petitioner through the years 1932 to September, 1938, to assert any claim, and notwithstanding his further neglect from September, 1938, to January, 1941, to assess the taxes now claimed, that some sort of a mythical lien would come out of nowhere and automatically become impressed upon respondent's assets whenever petitioner saw fit to make his demand. Petitioner's position as asserted before the Circuit Court of Appeals (pp. 22-23 of his opening brief) is as follows:

> "The liability for the taxes here in question was incurred by the receivers and unquestionably the receivers should have paid the same as expenses of administration. Sections 124 and 124a, 28 *U. S. C. A.; Boteler v. Ingels, supra.*
>
> ". . . we take the position that when the assets were returned to the debtor, the liens for unpaid taxes, theretofore held in suspension by reason of

the fact that such assets were *in custodia legis,* became impressed upon the assets in the hands of the debtor and have ever since remained as a charge upon them."

Actually there is nothing in 28 U. S. C. A., Section 124a or in the *Boteler* case which permits a taxing authority to sit idly by for years with full knowledge that the receivers were operating the business and incurring franchise tax obligations, permit the receivers to be discharged without taking any steps in the then pending proceeding to collect the tax and then seek to establish a lien against bankrupt's property after the property has been returned upon order of court without any reservation respecting the tax obligation.

Petitioner is ignoring the duty placed upon him by Section 16 of the Bank and Corporation Franchise Tax Act of the State of California (Petition, p. 23), for it is made his duty by law to compute "from any available information" and levy the amount of tax. Section 29 of the same act provides that "Taxes levied under this act shall constitute a lien upon all property *of taxpayer.*" Petitioner claims that *the receivers were the taxpayers* by the force of Section 124a of Title 28, U. S. C. A. but he seeks for the first time to make his levy in January 1941 and to impose a lien for the long-delayed demand upon property of the former alleged bankrupt after that property had again come into custody of the court by the force of the now pending Chapter X proceedings.

Petitioner does not point out and respondents are not able to discern wherein any conflict lies between the opinion of the Circuit Court of Appeals in the case at bar and in the *Boteler* case.

Petitioner Is Not Entitled to Present for the First Time on Appeal His Claim to a Lien Against Assets in the Hands of Respondent Trustee.

It will be remembered that petitioner's proof of debt filed in the present Chapter X proceedings [Tr. of Rec. pp. 36-40] makes no claim of lien against any property. In his amendment to claim filed long after the trial was had on his proof of debt and on the objections filed by respondents thereto, before the Special Master [Tr. of Rec. pp. 115-116], he for the first time asserts that the taxes "were a lien against the real property of the debtor" and in his prayer says "The undersigned pray that said claim for said taxes be allowed *as an unsecured claim* for taxes or as a secured claim for taxes."

It will be remembered that Rule 20(b) of the Circuit Court of Appeals for the Ninth Circuit requires that "when the error alleged is to a ruling upon the report of a master, *the specification shall state the exception to the report and the action of the court upon such exception.*"

And the rules of civil procedure for the District Courts of the United States adopted by the Supreme Court pursuant to the Act of June 19, 1934, Chapter 651 (48 Stat. 1064) specify in Rule 53(e)(2) with respect of an approval of a master's report that "within ten days after being served with notice of the filing of the report, any party may serve written objections thereto upon the other parties. Application to the court for action upon the report and upon objections thereto shall be by motion and upon notice as prescribed in Rule (6)(d)."

The objections made by petitioner to the master's report appear at pages 127-130 of the transcript of record. They consist of seven paragraphs or grounds of objection and

do not remotely suggest that petitioner attacked the master's report upon the ground that the master had not allowed petitioner a lien. In fact, the word "lien" does not appear in the objections except in the prayer.

Petitioner as appellant to the Circuit Court of Appeals filed no specifications of error and the only thing in the record in that regard is a "Statement of Points to be Relied Upon on Appeal" [Tr. of Rec. pp. 136-138] and the appellant's letter to the clerk of the Circuit Court after his appeal was perfected to that court [Tr. of Rec. pp. 176-177]. Appellant thus failed to specify his exception to the report of the master, as required in Rule 20(d) of the Circuit Court of Appeals for the Ninth Circuit, and has not at any time on appeal complained of the order of the court confirming the report of the Special Master.

The first time that petitioner clearly advanced the contention that he was entitled to a lien upon the assets of debtor now in the hands of the Chapter X trustee was before the Circuit Court of Appeals.

Petitioner May Not Now Complain Against the Findings of the Special Master and of the District Court.

In petitioner's "Specification of Errors to be Urged" before this court (petition, pp. 12-13) six grounds are specified. These differ materially in some instances from the five "Questions Presented" (Petition, pp. 2-3) but throughout both the "Questions Presented" and the "Specification of Errors to be Urged" complaint is made against findings of fact although it is true that petitioner does not so phrase his complaint but refers to the findings as being "holdings." It is submitted that such complaints

so made in phraseology referring to "holdings" though in truth complaints of the findings of fact, may not be reviewed by an appellate court. This is particularly true when the full record made before the court below is not presented on appeal. The record now before this court is very meager and incomplete. That the so-called reporter's transcript [Tr. of Rec. pp. 139-169] consists merely of excerpts is made clear by the "Designation of Contents of Record on Appeal" [Tr. of Rec. p. 170, *et seq.*] where at page 172 and in paragraph 19 of said designation the appellant specifies selected portions of the reporter's transcript, omitting all others.

The appellees were under no compulsion to place the complete record as made before the Special Master and in the district court below, in this record on appeal because in the detail of statement of points to be relied upon on appeal [Tr. of Rec. p. 137], the appellant suggests an attack only upon the finding that the receiver had filed a verified corporation franchise tax return for the years 1934-1935. Such finding is not identified by the appellant nor is any reference made in appellant's statement in respect of the insufficiency of the evidence to support such finding.

The findings of fact and conclusions of law proposed by the Special Master appear in the transcript of record, pages 88-113, inclusive. The Special Master has set forth more clearly than the petitioner the circumstances surrounding the present dispute.

When a Receiver in Bankruptcy Has Been Discharged and the Property Turned Over to the Company Unconditionally and Without Reservation, Upon the Accomplishment of a Composition, Claims Against the Receiver, Including Expenses of Administration Such as Franchise Taxes Accruing as a Result of the Receiver's Operations, May Not be Asserted Against the New Company.

Under the facts, disclosed by this record, the law is well settled that when the Franchise Tax Commissioner failed to assert his claim against the receiver, permitted an offer of composition to be confirmed, and without asserting any claim for unpaid taxes permitted the assets to be returned to the debtor corporation, petitioner is now barred from asserting against the debtor corporation any claim for franchise taxes during that period of time.

All taxes accruing during the receivership and subsequent to the receiver's appointment, are costs of administration as distinguished from provable debts. This distinction is stated by the authors of *Remington on Bankruptcy*, in Vol. 2, p. 231, in the following sentence:

> "A distinction must be drawn between taxes *owing by the bankrupt*, which are provable and dischargeable claims, and taxes which become *payable by the trustee* by reason of his conduct of the business of an estate. The latter are expenses of operation which must be paid out of the estate."

It is of course well settled that costs and expenses of operation incurred by a receiver or trustee in bankruptcy are obligations of the trustee or receiver and not of the

alleged bankrupt, although the receiver or trustee is entitled to use the assets of the alleged bankrupt in his possession in payment of such charges as are held to be proper by the appointing court. That is the extent of the claimant's remedy, and in the absence of special circumstances hereafter enumerated no action may be maintained against the bankrupt after the discharge of the receiver or trustee upon those obligations remaining unpaid. In the case of *Michigan v Michigan Trust Co.* (1932), 286 U. S. 334, 76 L. Ed. 1136, 52 S. Ct. 512, in an action brought against the receiver to compel payment of certain corporate franchise taxes, the court described those taxes as expenses of administration in the following language at page 344:

> "Viewing the receivership in its true light as one, not to wind up the corporation, but to foster the assets, we think the annual taxes accruing while the receiver was in charge must be deemed expenses of administration . . ."

In the decision of the Circuit Court of Appeals, Sixth Circuit, in the case of *Heyman v. United States* (1923, CCA 6), 285 Fed. 685, a trustee in bankruptcy was ordered to pay a war revenue tax accruing during the operations of the business by the trustee. The court there held that the taxes so accruing were obligations of the trustee as expenses of administration, and were not obligations of the bankrupt. In so holding the court used the following language at page 689:

> "As this obligation of the trustees was one that arose during the administration of the estate, and was no debt of the bankrupt, it is to be paid as other expenses of administration, out of the estate before distribution among the general creditors."

It has been repeatedly held that various taxes accruing during the operation of an alleged bankrupt's business by a receiver or trustee, are costs and expenses of administration, and the following three cases so holding are cited as examples, their authority being cumulative with that of the above-quoted two cases:

Prudential Insurance Co. v. Liberdar (1934, CCA 2), 74 F. (2d) 50;

Central Vermont Ry. v. Marsch (1932, CCA 1), 59 F. (2d) 59;

Hammond v. Carthage Pulp Co. (1925, CCA 2), 8 F. (2d) 35.

While it is of course true that obligations accruing subsequent to the filing of the petition in bankruptcy are not provable debts, and if they are incurred by the bankrupt itself the creditor has no right to participate in the assets held by the court and may thereafter collect them from the bankrupt, it is also true that if the obligations accruing subsequent to the petition are incurred by the receiver or trustee such creditors are entitled to participate in the bankrupt estate as costs of administration. Indeed they have priority over the claims of general creditors. The remedy is provided in Sec. 102 of Title XI, USCA which reads in part as follows:

"(a) The actual and necessary costs and expenses incurred by officers in the administration of estates shall, except where other provisions are made for their payment, be reported in detail, under oath, and examined and approved or disapproved by the court. If approved they shall be paid or allowed out of the estates in which they were incurred."

Two things are important in the above-quoted section. In the first place that section contemplates that the sole remedy for collection of costs of administration shall be an application for an allowance out of the estate *unless* "other provisions are made for their payment." In the instant case it is established that no other provisions whatsoever were made for the costs incurred by the receivers [Tr. of Rec. p. 91]. In the second place, this section contemplates that not even shall the estate be liable unless the claims be first approved and allowed. This condition precedent to any recovery must be complied with before any rights accrue to the claimant. This condition precedent was not complied with herein and by his failure to so comply the petitioner has lost any right or remedy for the recovery of the tax claimed.

Petitioner is in the same position as the claimant in the case of *Chicago Joint Stock Land Bank v. Minnesota Loan & Trust Co.* (1932, CCA 8), 57 Fed. (2d) 70, wherein the court held that knowledge of the existence of the receivership put the creditor on notice and charged it with the duty to keep itself informed as to the orders made therein relative to the right to file claims. The court in so holding used the following language, at page 73:

> "It had knowledge of the receivership and was charged with notice that the receivers could act only pursuant to order of court. It also was placed upon inquiry as to all proceedings taken in the receivership matter, including the order limiting the time for filing claims."

Moreover, it has also been held that where the assets of a debtor are being administered in a receivership the

publication of notice as prescribed by the court constitutes notice to all concerned. In the case of *North American Co. v. St. Louis and S. F. R. Co.* (1922, D.C.E.D. Mo.), 288 Fed. 612, in a decision by Judge Sanborn, a claimant was denied the right to have the order discharging the receiver set aside for the purpose of allowing it to file a claim, even though the claimant had no actual notice of the order limiting the time for filing claims. In that case the court stated the rule, at page 622, as follows:

> "They insist, and it is conceded, that they had no actual notice or knowledge of the interlocutory decree and its limitation of the time to file claims until August 29, 1916, the day of the confirmation of the sale. But in cases of the administration and distribution of property in the exclusive possession and control of courts of equity and probate courts, reasonable publication of their orders limiting the times to file claims, and barring the claims of those who do not file within the times fixed to participate in the benefits of such property or its proceeds, constitute regular and binding notice thereof, and further notice or knowledge is not indispensable to bar the claims.
>
> * * * * * * * *
>
> "The counsel for interveners knew soon after May, 1913, that all the property of the railroad company had been delivered to the possession and control of this court for administration and distribution, and that the railroad company had none of it. They knew that in cases of this character the common, lawful, and effective practice of courts of equity was to make and publish by advertisement in the newspapers decrees or orders limiting the times to present claims to such courts to participate in the benefits of the administration and distribution of the property, and

by such orders or decrees to bar from participation therein the claims of all those who failed to file statements of them within the time fixed. By an examination of the record of this court at any time between May 29, 1914, and February 1, 1916, the interveners or their counsel could have learned of the interlocutory decree and its effect. Notice of facts and circumstances which would put a man of ordinary prudence and intelligence on inquiry is, in law and in equity, notice of all the facts a reasonably intelligent inquiry would disclose. *Wood v. Carpenter,* 101 U. S. 135, 137, 141; 25 L. Ed. 807. The interveners' notice of the exclusive possession and control by this court, by its receivers, of all the property of their debtor for the purpose of administration and distribution, was sufficient to put a claimant of ordinary prudence on inquiry as to the course requisite for him to pursue to share therein, and such an inquiry would have disclosed, as it did disclose to hundreds of other claimants, the limitation and bar of the interlocutory decree. If the interveners failed to exercise like prudence and diligence, that fact does not appeal with sufficient force to induce a court of equity to relieve them of the injurious effect of that neglect, by imposing it upon the diligent claimants who complied with the decree of the court and their successors in interest."

The Franchise Tax Commissioner having, as the court has found, not only notice and knowledge of the receivership but also knowledge during the years that the receivers were operating the business, was charged with the duty of presenting his claim prior to the termination thereof, and his failure to do so has forever barred the claim, since, at the termination of the receivership, not

only was the receiver discharged and relieved by the court of all further liability, but by its decree confirming the composition, the court judicially freed the debtor of all claims not arising from that composition agreement. It is of course too well established to require the citation of authorities that *the approval of a composition in bankruptcy constitutes and is the equivalent of a discharge in bankruptcy.*

The rule in respect of equity receivers is briefly stated in *Clark on Receivers*, Vol. 1, page 1010, as follows:

> "If the receiver has been discharged and the property turned over to the new company unconditionally and without reservation, the claims against the receiver will ordinarily go unpaid."

And, again, in the same volume, at page 1008, as follows:

> "The effect of discharge of a receiver and surrender of jurisdiction over the trust without any reservation as to existing claims is to release not only the receiver, but also the property from further liability."

This same conclusion was reached by the Supreme Court of Indiana in *Johnson v. Central Trust Co.* (1903), 65 N. E. 1028, 159 Ind. 605, wherein the court stated its conclusion in almost identical language with that above-quoted, at page 1030:

> "The effect, therefore, of a discharge of a receiver, and the surrender of jurisdiction over the trust, without any reservation as to existing claims, is to release not only the receiver, but also the property, from further liability (citing cases)."

This rule has been recognized for many years in the federal courts. The earliest case most frequently cited is *Farmers' L. & T. Co. v. Central R. R. of Iowa* (1880, C.C.,D. Iowa), 7 Fed. 537, in which case the court had reserved jurisdiction and ordered that the corporation be liable for expenses incurred in the management of its property by the receivers. However, in the decision the court, in considering the result of a failure to so provide, stated the following, at page 539:

> "But what would be the remedy of the claimant if the court should discharge the receiver, and place the fund or property beyond its control, by turning it over, without reservation, to a purchaser? I confess that if the fund or property should be turned over to a purchaser without reservation, I am at a loss to see what the remedy of the claimant would be—as, for example, the old railroad company—in this case. How could he found a personal action of tort or contract against a party who would be a stranger to the tort or contract? How could he count upon or prove the tort or contract against a party who never committed the one nor made the other?
>
> "It has been suggested by an eminent judge that the receiver might be treated as the agent of the defendant railway company and the action thus maintained directly against the company. But it seems to me that this position is untenable. There is not the slightest analogy between the relation of a receiver to the railway company and the relation of an agent to his principal. . . . To make a railway company responsible for the acts and contracts of an officer whom they can neither appoint nor control, direct, nor remove, on the ground of agency, would be to violate the fundamental principles of the law of agency."

The obligations incurred by a receiver to pay taxes are, in essence, undistinguishable from obligations arising from tort or contract. In fact, taxes have always been considered the result of an implied contract between the taxpayer and the state. The above federal decision was followed in the subsequent federal case of *Davis v. Duncan* (1884, C.C.,S.D. Miss.), 19 F. 477, wherein the court stated its conclusions as follows:

> "The railroad company is not liable for the injuries complained of in the bill, for the reason that they were committed while it was out of possession of the property and had no control over it. This conclusion is sustained by principle and authority. . . . The corporation took the property free from any liens or claims growing out of the receivership, except those reserved and provided for by the decree under which the surrender was made to the company and under which it is now held."

In the instant case the receiver was discharged unconditionally and the property and assets in his hands restored to the corporation without any reservation of jurisdiction to find the corporation liable for expenses incurred during the receivership or other obligations of the receiver, and, in fact, *with an express adjudication that the corporation should be liable for only those* claims acknowledged and included in the composition [Tr. of Rec. p. 90].

Accordingly it is submitted that petitioner, with legally sufficient notice and knowledge of the proceedings, allowed the receiver to be discharged without presenting claim for taxes incurred by him, and thus not only is the receiver relieved of any liability, but also the cor-

poration is to a like extent immune (1) because the *obligations were never the obligations* of the corporation, and (2) because the *decree restoring the property to the corporation did not purport to make it liable for expenses and obligations incurred by the receiver.*

Thus, it is urged that by failing to present a claim for the taxes now asserted to have become due during the receivership, the petitioner lost all right to collect those taxes subsequent to the receiver's discharge.

The Alleged Taxes Never Became a Lien Upon the Real or Personal Property of the Corporation and the Claim Is Also Barred by the Provisions of Sections 25 and 28 of the Bank and Corporation Franchise Tax Act.

A levy is a condition precedent to a lien. (*Franchise Tax Act,* Petition p. 23.) No levy or assessment was attempted until after the commencement of these Chap. X proceedings.

The Franchise Tax Commissioner may not avoid the result of his neglect to assess and collect the taxes currently as they became due during the former receivership upon the assertion that such taxes became a lien on the alleged bankrupt's assets in proceedings No. 18884-H and were therefore not affected by the discharge of the bankrupt and the receiver therein. It is well established such taxes did not become a lien upon the bankrupt's property, since once the property of a corporation has been taken into *custodia legis* by the appointment of a receiver, no lien thereon may be thereafter obtained. It may be noted that the Bankruptcy Act makes provision for the perfecting of a lien subsequent to the filing of a petition in bank-

ruptcy in such cases as the lien had accrued prior to the filing of the petition, but for the failure to comply with some statutory requirement had not been perfected. This provision does not authorize the acquisition of a lien for a claim arising subsequent to the filing of a petition in bankruptcy and is no aid to the claimant herein.

The fact that the filing of the petition in bankruptcy brings the property into the custody of the court is briefly stated in the leading case of *Ex parte Baldwin* (1934), 291 U. S. 610, 78 L. Ed. 1020, 54 S. Ct. 551, as follows at page 615:

> "All property in the possession of a bankrupt of which he claims the ownership passes, upon the filing of a petition in bankruptcy, into the custody of the court of bankruptcy."

The rule that once the court has obtained custody of the property no liens may be obtained against it, is also briefly stated in the case of *Straton v. New* (1931), 283 U. S. 318, 75 L. Ed. 1060, 51 S. Ct. 465, in the following language at page 321:

> "The filing of the petition is an assertion of jurisdiction with a view to the determination of the status of the bankrupt and a settlement and distribution of his estate. This jurisdiction is exclusive within the field defined by the law, and is so far *in rem* that the estate is regarded as in *custodia legis* from the filing of the petition. * * * It follows that liens cannot thereafter be obtained nor proceedings be had in other courts to reach the property, the district court having acquired the exclusive right to administer all property in the bankrupt's possession."

The case of *Blakistone v. The State* (1912), 83 Atl. 151, 117 Md. 237, from which quotations at length are made by the master in his report [Tr. of Rec. p. 103 *et seq.*], seems particularly applicable to the point here involved.

Petitioner asserts, and respondents concur, that under the 1934 amendment to the Judicial Code (Sec. 124(a), Title 28, U. S. C. A.), the receiver in bankruptcy was required to pay the state franchise tax. *The implicit acceptance of that proposition is the basis of the decision herein.*

Thus the obligation to pay the franchise taxes was that of the receivers in bankruptcy and not of the corporation. No lien could attach against the property in *custodia legis* and there was no corporate obligation which would support the imposition of a lien upon the assets upon the accomplishment of the composition, the discharge of the receiver, and the return of the assets to the corporation. Moreover, both the obligation and the supposititious lien, at least so far as the taxes for the years 1934 and 1935 are concerned, are barred by the provisions of the California Bank and Corporation Franchise Tax Act, the master having found, as conceded by appellant at page 14 of his brief before the circuit court of appeals that the returns filed by the receiver were the returns contemplated by the Act.

Appellant's Neglect, Delay and Lack of Diligence Should Estop Him From Asserting Any Liability Which Would be Prejudicial to the Creditors Who Became Creditors Subsequent to the Termination of the Prior Bankruptcy Proceeding.

No claim was ever made by petitioner for any unpaid franchise taxes *until January 4, 1941, after the debtor was again in bankruptcy and after the lapse of many years* and after debtor's property again became in *custodia legis.* During the time for which taxes are now claimed, there was paid annually all taxes demanded by the petitioner upon the right "to be." At the hearing before the special master, counsel for appellant stipulated that the Franchise Tax Act, except for the payment of $25.00 per year, imposed taxes upon the right "to do." Even without such admission, it is clear from the language of the Act that this is so.

Since the corporation was not engaged in business, no taxes other than those that were paid for the right "to be" accrued against the corporation. Petitioner, by his own neglect and failure to act, omitted to collect the taxes from the receiver at the only time that he could lawfully do so. He never had the right to collect those taxes imposed upon the right "to do" from the corporation.

The taxes now sought to be collected were incurred by the receiver and were payable only as an expense of administration in the receivership proceeding. Had the

petitioner timely asserted his demand for franchise taxes from the former receiver, filed his claim in the then pending bankruptcy proceeding and had obtained a determination of the validity of his claim as a condition to the accomplishment of the composition, the bankruptcy court would undoubtedly have required the payment of a sufficient cash deposit to pay said franchise taxes along with other expenses of administration. The record is completely devoid of any evidence or suggestion that any of the money that was used to effect the composition came from the corporation.

The effort of petitioner now to impose this additional burden upon the present creditors of the debtor is inequitable because they have become creditors subsquent to the accomplishment of the former composition and had the right to assume that their debtor had become discharged of all obligations prior to the composition other than those expressly set forth in the proposed composition and in the order of the court confirming the same. The record shows that the present demand of petitioner was not imposed, by the accomplishment of the composition, upon the debtor.

It follows that the attempt to collect this ancient demand from the debtor in these proceedings is prejudicial to the present creditors who became so subsequent to the termination of the prior bankruptcy proceedings, and particularly are the present demands of petitioner prejudicial to such creditors because they had no notice or knowledge of any claim so asserted. Accordingly, such creditors were entitled to assume that the composition disposed of all claims and liabilities theretofore existing and the allowance of the present demand in this proceed-

ing would result in the depreciation of the assets of this estate to which those creditors are entitled to look for payment.

It is said in 29 *Corpus Juris*, at page 212, that

> "It is an inherent doctrine of equity jurisprudence that nothing less than conscience, good faith, and reasonable diligence can call courts of equity into activity, and that they will not grant aid to a litigant who has negligently slept on his rights and suffered his demand to become stale where injustice would be done by granting the relief asked."

Conclusion.

It is respectfully submitted that the decision of the Circuit Court of Appeals in this cause is in conformity with all other decisions of this Honorable Court and other Circuit Courts of Appeal on the subject.

Respectfully submitted,

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